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C O N F I D E N T I A L SECTION 01 OF 02 VILNIUS 000200

SIPDIS

STATE FOR ASSISTANT SECRETARY TONY WAYNE AND EUR/NB

E.O. 12958: DECL: 02/28/2014
TAGS: PREL PGOV ECON EFIN LH
SUBJECT: LITHUANIAN MINISTER USPASKICH'S VISIT SCENESETTER

REF: A. VILNIUS 1099

¶B. VILNIUS 1323
¶C. VILNIUS 1352
¶D. VILNIUS 1523
¶E. VILNIUS 1439

Classified By: ECONOMIC OFFICER MIGUEL KAMAT
FOR REASONS 1.4 (B) AND (D)

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SUMMARY
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¶1. (C) Your meeting with the Baltic Ministers of Economy will provide an opportunity to underscore to Lithuania's Minister Victor Uspaskich the need to do more to attract U.S. direct investment. Uspaskich, who came to office in December 2004, has publicly recognized that increasing foreign investment is key to Lithuania's continued growth, but he yet to take action to improve the country's investment climate. The Minister's participation in the Baltic Ambassadors' Trade and Investment Conference in Washington is a step in the right direction. Uspaskich will meet you on his way back from California where he will have had meeting with high-profile IT companies, whom he hopes to draw to Lithuania. Uspachkich, a Russia-born multi-millionaire who made his fortune as a trader in ferrous metals, Gazprom broker, and now pickle magnate, whom other politicians would portray as a populist, presents himself as all business and is spearheading GOL efforts to improve the business climate. End Summary.

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BACKGROUND
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A Growing Economy
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¶2. (U) Lithuania's robust economic growth continues to grow, though it has slowed from a nine percent GDP high jump of 2003 to a still enviable 2004 6.6 percent rise. Analysts forecast annual average real GDP growth of 5.7 percent in 2005-06. Domestic demand will continue to drive economic growth, as households benefit from wage increases, falling unemployment, and low lending rates. Uncertainty about the future of the oil supply and management of Lithuania's Mazeikiu Nafta oil refinery, currently under management of the major shareholder Yukos, could slow growth even more through 2005. Disruptions in the flow of oil, or price hikes would most acutely affect the manufacturing sector, which constitutes some 20 percent of GDP. Annual average inflation, which was 2.9 percent at the end of 2004, will rise in concert with rising electricity and gas prices, and wage costs, while the trade deficit will widen as a result of the increasing trade imbalance with Russia and other trading partners.

Fiscal Discipline
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¶3. (U) The GOL is trying to implement key reforms to sustain growth and help ensure Lithuania's acceptance to the EU's economic and monetary union in 2007. Its economic policy goals include improving the business environment to boost greenfield investment, expanding the revenues through introduction of a real estate tax and improved VAT collections, and improving the country's administrative capacity to fully absorb EU funding. The government plans to cut income tax from 33 percent to 24 percent over a period of three years beginning in 2006. The GOL has set its fiscal deficit target at 2.75 percent of GDP for 2005, within the Maastricht limit of three percent, but a push by Uspachkich's Labor Party to fulfill a campaign promise and increase social spending, may increase the deficit and tensions within the government.

Increasing U.S. Investment
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¶4. (C) Lithuania boasts one of the fastest growing economies in Europe, but, with GDP per capita at about 40% of the average EU-15, it has a long way to go, and there is plenty

of room for new investment. The United States is currently the sixth largest source of foreign direct investment in Lithuania with USD 479.3 million in total investments. In the last month, U.S. companies have announced major new investments or intentions to invest. Citigroup Venture Capital International invested USD 53 million to acquire a significant minority stake in Lithuania's second-largest food retailer. The engineering firm Foster Wheeler won a USD 43 million contract for the construction and supply of a new gasoline hydro treatment unit at the Mazeikiu Nafta refinery. Norcon International announced plans to invest up to USD 100 million to build waste treatment and processing centers in Lithuania's two largest cities.

Improving the Investment Climate
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¶5. (C) Lithuania offers investors a highly educated workforce, low corporate profits tax, low cost of living, relatively low cost labor (by European standards), and high quality of life. Companies on the ground and business analysts tell us that establishing a business in Lithuania is overly complicated, however. It would be useful to encourage the GOL to improve the transparency of, and accountability within, the regulatory system. More than 50 agencies regulate the business environment. Investors complain that many laws and regulations are vague and often contradictory, and that bureaucratic procedures to obtain clearances burdensome. They also point to discouragingly high labor-related taxes. With salaries and other business costs expected to rise to EU standards over time, Lithuania will need to do better, where it can. While taxes structures obviously lie outside the purview of the Minister of Economy, you could encourage Uspaskich to work within his Government to improve this picture. Finally, the visit affords an opportunity to enlist Uspaskich's support in promoting greater government support for international education in Lithuania is a key factor in attracting foreign investment (not to mention recruiting Embassy Vilnius personnel!).

¶6. (C) The visit also provides an opportunity to comment on the need for the GOL to continue tackling corruption. Transparency International's recent Global Corruption Survey noted that one in three Lithuanians admitted paying a bribe within the last twelve months. You might also stress the need for the GOL to diversify its energy options and maintain its energy security. Virtually all of Lithuania's natural gas and crude oil supplies come from Russia. The GOL is considering additional options, such as the construction of additional gas pipelines, importation of oil and/or gas from Nordic countries, and the connection of the Lithuanian electrical grid to its Polish counterpart (ref. E). Finally, you might encourage the GOL to continue its privatization program. Major assets still in government control include the electric power company, the national airline and the railways.

Bio Note
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¶7. (SBU) Uspaskich, 45, is one of Lithuania's richest men. A major landowner, he has a declared net worth of Euros 46 million (USD 60.7 million), though his actual net worth may be several times greater. Uspaskich was born and raised in Russia's Arkhangelsk district. He studied in Moscow and received a Master's degree in economics from Kaunas Technological University. He moved to Lithuania in 1987, and obtained Lithuanian citizenship around 1991. He started a major food processing and retail trade firm, Vikonda, then made a fortune serving as an intermediary for Gazprom's gas sales in Lithuania. He maintains close ties with Russia, helping to rebuild several churches there, and receiving the Russian orders of St. Vladimir and St. Danil. Uspaskich has not shied away from using his wealth to promote his causes and political allies, particularly in founding the upstart, and highly successful, Labor Party last year.

¶8. (C) Two of Uspashkich's four children study in American universities. He speaks, Russian, Lithuanian, and understands some English.

¶9. (U) Renata Dromantaite, who will accompany Uspaskich, served as Economic Specialist to Embassy Vilnius until January 2005, when she assumed her current position as the Minister's Economic Advisor.

Comment
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¶10. (SBU) Uspaskich's visit will present an opportunity to become acquainted with an influential Lithuanian leader who not only controls the influential Economic Ministry, but also someone who will significantly impact the face of Lithuania for years to come. It is also a chance to advance the USG interest in promoting a more investor-friendly environment in Lithuania.

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